



STEVE WESTLY
California State Controller

May 19, 2003

Dear Legislative Leaders:

As Controller, my role is to ensure that California can pay its bills. We have various tools to meet these financial obligations including short-term borrowing. Each tool, however, has statutory and legal restrictions.

Employees, vendors, local governments, lobbyists, unions and the media regularly ask what payments would be made during a no-budget situation. I have prepared an overview of what would occur in a no-budget situation. This detailed explanation will further illustrate why timely action on the budget is so important.

Borrowing

The instrument available to the state for short-term borrowing is a Revenue Anticipation Warrant (RAW), a form of borrowing that allows the State to meet its cash flow needs across two fiscal years. RAWs are commonly referred to as "bridge" loans and are the only borrowing tool available for this purpose. Last year the Controller issued \$7.5 billion of RAWs.

The Governor recently authorized my request to borrow an \$11 billion RAW--the maximum amount allowable under formulas involving borrowing between State General and Special Funds. This is the largest such borrowing in California history and is a sobering reminder of the scope of our problem and the need for a timely solution to the current fiscal crisis.

I am traveling to New York this week to meet with the rating agencies to negotiate the State's credit rating and the best possible interest rate. My team of financial advisors is also working to obtain credit enhancements to get the best rates. All of these efforts include representatives from the Department of Finance, the Treasurer's Office, and the Attorney General.

May 19, 2003

Page 2

No-Budget Situation Restrictions

In years when a budget is not signed on time, the Controller must suspend certain payments. For example, many vendors and contractors, including small businesses and non-profits, cannot be paid for goods and services provided to State agencies after July 1. Legislative staff and exempt employees of the Governor and Constitutional officers cannot be paid. In addition, highway User Taxes cannot be apportioned to cities and counties for street and road projects and Cal Grants to students in higher education cannot be paid.

The Controller can pay federally mandated costs such as Medi-Cal, continuous appropriations such as gas taxes apportioned to cities and counties, and constitutionally protected payments, such as those to schools and debt service.

Jarvis vs. Westly Court Ruling

This year, the recent ruling in *White vs. Davis* (or *Jarvis vs. Westly*) further complicates matters. The court made two important findings.

First, the court left intact the Appellate Court's determination that Proposition 98 did not contain an appropriation for school funding. While some school payments will continue to be authorized under the revenue limit, other payments for mandated programs and categorical programs may not qualify. We are working with the Superintendent of Public Instruction in an effort to clarify this, hopefully this week.

The court did not resolve the issue of pay for State employees. The court suggested most employees be paid minimum wage (\$6.75 an hour) when a budget has not been passed, but left the door open for the Controller to determine whether this is feasible. The court also suggested that those who work overtime should receive full pay, while those who do not should receive minimum wage. In my judgment, it is not feasible to implement a multi-tiered pay system for 4500 job classifications within the next 60 days. I believe it is simply unfair to make State employees the victims of the budget stalemate, and I will pay their regular salaries.

Deferring or Delaying Payments

During a no-budget situation, California will face a cash shortage. We believe that without a budget, we would likely run out of money in September.

May 19, 2003

Page 3

If that happens, I will manage our cash flow by delaying those payments that are not legally required to be made by a specific date. This may incur interest fees and penalties, but we would make every effort to negotiate terms that minimize those costs. Examples include unclaimed property reimbursements, income tax refunds, and other continuous appropriations.

Additional Borrowing

With or without a budget, we will need to borrow additional funds early in the next fiscal year. With a budget in place, the Treasurer can issue a Revenue Anticipation Note (RAN), which is done most years to balance out the normal peaks and valleys in the State's revenue stream. If we have a budget in place, we can borrow the funds we need well before we have a shortfall.

Without a budget, I will be forced to attempt to pursue additional borrowing at what are likely to be substantially higher interest rates. Attempting to borrow additional funds in a no-budget situation would be unprecedented. In that scenario, it is possible that investors will refuse to lend the State anymore money. Even if I am able to borrow more, I would only be able to borrow a very limited amount of money—enough to operate state government for one to two weeks.

Registered Warrants

The Controller has issued Registered Warrants, known as IOUs, only twice in California history; once during the Depression and again in the early '90's. The availability of this tool has been restricted by a court ruling (*Parr v. California*). This is truly an option of last resort – and one that would have severe long-term economic costs to the State. I have no plans to issue Registered Warrants. Fortunately we can avoid IOUs by passing a timely budget.

Conclusion

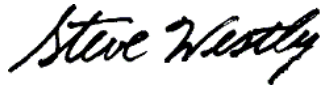
None of us has an easy job in this fiscal crisis. You have the task of crafting perhaps the toughest budget ever. As Controller, I am faced with the task of issuing the largest RAW in the State's history. We have a difficult job before us but I am confident we will be successful.

May 19, 2003

Page 4

I hope this information is helpful as we work together to solve the State's fiscal crisis. My staff and I are available to answer any questions you may have.

Sincerely,

A handwritten signature in black ink that reads "Steve Westly". The signature is written in a cursive, slightly slanted style.

STEVE WESTLY

State Controller

SW/sr

cc: The Honorable Gray Davis
Governor of California

The Honorable Phil Angelides
California State Treasurer

The Honorable Bill Lockyer
California State Attorney General

The Honorable Steve Peace
Director, Department of Finance